At a Small Firm, SEC Probe Spelled Chaos

Online Marketer L90 Confronted Resignations, Delisting Threat And Costly Document Searches

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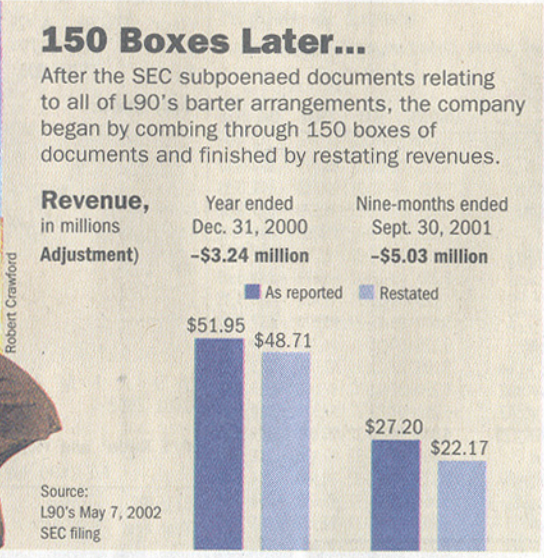

THE FIRST PHONE CALL concerned William Apfelbaum. The second one alarmed him.

The semiretired outside chairman of online marketing company **L90** Inc. was at his desk in late January at his home in leafy Greenwich, Conn., gazing at the water, when he took the first call. The Securities and Exchange Commission "has subpoenaed documents relating to the company's transactions with **Homestore.com**," he recalls being told by John Bohan, L90's chief executive. He says the executive assured him no big problems loomed.

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Several days later, Mr. Apfelbaum, 55 years old, got the other call, this time at his office in Greenwich. Now, the SEC was subpoenaing documents relating to all barter-like arrangements, raising questions about whether the company had properly booked revenue from such transactions. Mr. Apfelbaum says he remembers feeling the jolt of an adrenaline rush. "It spread from my chest, out over my arms," he says. "Here we go," he remembers thinking, knowing L90 was in serious trouble. "I stood up, got a bottle of water and started making phone calls."

The series of late January phone calls led to an announcement on May 6 that L90 would restate the revenue it had posted in its 2000 and 2001 financial statements, following an internal inquiry by the company's audit committee, of which Mr. Apfelbaum is a member, with the aid of a team of lawyers and forensic accountants. Amid the inquiry, Mr. Bohan, the company's young entrepreneurial founder, stepped down and was succeeded by Mitchell Cannold, 53, the dot-com company's self-described gray-haired and middle-aged CEO, who previously was president of a business-development unit for Sony Corp.

Behind the management shake-up and restatement by the Santa Monica, Calif., company, which reduced revenue by $8.3 million, or 10%, for those periods, was a three-month scramble to unravel a series of complex barter transactions, amid threatened delisting by Nasdaq, a formal investigation of the company's accounting by the SEC and mounting class-action lawsuits.

Getting to the bottom of the questionable transactions wasn't easy. The effort involved combing through documents that filled 150 boxes the size of file drawers in order to comply with the SEC's request, a task that generated $400,000 in copying costs.

By the time it was done, the internal investigation had turned up evidence that L90 improperly had recognized revenue from roughly 12 barter arrangements—deals in which cash transactions substantially offset one another when aggre-

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gated—including two deals with Homestore, an online real-estate-services company. The results of the investigation, detailed in interviews with the company's lawyers and executives, show how at least one dot-com company engineered barter arrangements that amounted to little more than "check swaps," as they were referred to internally, in order to artificially boost its revenue as its own business was faltering. The barter deals in some cases were three-way check swaps, making the paper trail harder to follow. A Homestore spokeswoman declined to comment.

William Apfelbaum

In one instance, according to a lawyer familiar with the transaction, L90, fellow online-advertising company **Hi-Speed Media** and Homestore each sent wire transfers for similar amounts the same day, all purportedly for advertising services. L90 booked the difference between its outgoing transfer and its incoming transfer—$250,000—as revenue. Hi-Speed Media confirmed the basic transaction, though it differed about some details.

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Now, L90 is facing the daunting task of trying to convince employees, investors and customers, not to mention regulators, that it has cleaned up its act and can rebuild L90's business in a tough environment. Whether it will succeed is unclear. The company and employees could face future enforcement actions by the SEC. The company has been rushing to meet a deadline today for filing its restated results to keep its shares listed on Nasdaq. Back in early 2000, when it went public, L90 briefly was a market darling, quickly doubling in price to $32; yesterday, the shares stood at $1.29, down six cents, in Nasdaq Stock Market trading.

But the story behind L90's investigation into its own accounting improprieties is part of a broader picture as well. It is one of more than 50 companies whose accounting practices are currently being investigated by the SEC. In many cases, these companies are under scrutiny for a variety of practices that the SEC believes were used to inflate their top lines as the technology boom faded in 2000.

In particular, the SEC is zeroing in on what regulators refer to as "round trip" transactions, in which companies swapped assets or services and improperly recognized revenue from the transactions. In many cases, the SEC is finding, there was little economic substance to such deals. "By trading with each other, some companies have given the impression of activity, when, in fact, they may have just been scratching each other's backs," says Charles Niemeier, head of accounting in the SEC's enforcement division.

Throughout February, teams of lawyers and accountants from **Arthur Andersen** LLP, L90's auditor, camped out at the company's headquarters, often working through the night. Besides the sheer volume of documents, another issue was the degree to which some company managers were willing to aid the probe. "It was like a needle in a haystack," says Mr. Apfelbaum. A lawyer for Mr. Bohan says the executive did try to cooperate, adding that there is nothing inherently wrong with barter transactions.

In early March, the investigation hit a low. Mr. Apfelbaum met in a conference room at L90 headquarters to discuss matters with the audit committee's lawyers, Ira Lee Sorkin, partner at Carter Ledyard & Millburn and a former enforcement chief at the SEC, and Daniel Horwitz, of the same firm.

"We couldn't figure out what was going on, and we were under siege. We were looking at a delisting by the Nasdaq. We were under investigation by the SEC. We were facing class-action lawsuits, and employee morale was at an all-time low," Mr. Apfelbaum says. "We had given the SEC the initial 75 boxes, and we didn't have the damn people to do the Xeroxing for the next 75."

Mitchell Cannold

Midway through the investigation, Mr. Bohan, as well as fellow company founder Mark Roah and Thomas Sebastian, the chief financial officer, resigned, following out the door Lucretia Bickerton, the company's previous director of finance, who had resigned in late January. Mr. Roah, Mr. Sebastian and Ms. Bickerton all declined to comment through their lawyers.

About this time, the audit committee hired a forensic accounting firm, which put its expertise to work sifting through 10 feet of documents relating directly to the questionable transactions.

Two days after Mr. Bohan resigned, Mr. Cannold flew to Los Angeles to meet with Mr. Apfelbaum and other board members. His first day on the job, he was speaking to employees on a conference call in an attempt to stem the attrition. "I told them it was time for mature leadership in the Internet," Mr. Cannold says. "These people needed to be led. We have a generation of 32-year-olds who have invested everything in people who were their same age. They got disappointed, and they got burned."